[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS

(H.R. 700, H.R. 907, H.R. 1343, H.R. 1773, H.R. 2129, H.R. 2686, H.R. 3284, H.R. 3388, H.R. 3528, H.R. 4167, H.R. 4507, H.R. 4779, H.R. 5022, H.R. 5199)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON OCTOBER 3, 1984

PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The 14 bills described in this pamphlet have been scheduled for a public hearing on October 3, 1984, by the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means.

The bills scheduled for the hearing are: H.R. 700 (relating to special deduction rule for travel and transportation expenses of construction workers); H.R. 907 (expansion of exclusion for employer-provided meals to cover certain off-premises meals); H.R. 1343 (bad debt reserves for stock savings banks); H.R. 1773 (exemption from unrelated business income tax for sales of membership lists by certain organizations); H.R. 2129 (allocation of property taxes among tenant-stockholders in cooperative housing corporations); H.R. 2686 (business development companies); H.R. 3284 (deduction for loss in value of bus operating authorities); H.R. 3388 (application of section 252 of Economic Recovery Tax Act of 1981 to certain transfers in 1973); H.R. 3528 (deduction for loss in value of freight forwarder operating authorities); H.R. 4167 (exemption from unrelated business income tax for income from certain oil and gas property); H.R. 4507 (allowance of investment tax credit to members of certain tax-exempt religious organizations); H.R. 4779 (exemption from windfall profit tax for certain production); H.R. 5022 (denial of percentage depletion for income from certain lease bonus or royalties); and H.R. 5199 (applicability of farm syndicate rules of section 278(b) to inedible fruits and nuts).

The first part of the pamphlet is a summary of the bills. This is followed in the second part by a more detailed description of the bills, including present law, explanation of provisions, effective dates, and tentative revenue estimates.

I. SUMMARY

1. H.R. 700—Messrs. Stark and Hance

Special Deduction Rule for Travel and Transportation Expenses of Construction Workers

Under present law, traveling expenses (including meals and lodging) are deductible if incurred while away from home in the pursuit of a trade or business (Code sec. 162(a)(2)); however, no deduction is allowed for personal, living, or family expenses, including the cost of commuting to and from work (sec. 262). In general, traveling expenses are deductible if incurred in connection with temporary employment and the taxpayer has a regular or principal place of business (or, in its absence, a regular place of abode) away from which the temporary employment takes place. By contrast, traveling expenses incurred in connection with employment which is considered to be of indefinite or indeterminate duration generally are not deductible.

Under the bill, a construction worker would be allowed to deduct travel and transportation expenses (including meals and lodging) for the first two years at a job site which is located more than 30 miles from his or her home, even if the employment could be considered of indefinite duration. The bill also would provide that after the worker's first two years at such a site, the determination of whether the job was temporary (so that travel and transportation expenses would still be deductible) must be made on the basis of all the facts and circumstances, subject to three special rules set forth in the bill.

The special deduction rule in the bill for construction workers would be effective on enactment.

2. H.R. 907—Mr. Vander Jagt

Expansion of Exclusion for Employer-Provided Meals to Cover Certain Off-Premises Meals

Present law excludes from gross income the value of meals furnished to an employee (or to the employee's spouse or dependents) by or on behalf of the employer for the convenience of the employer only if the meals are furnished on the employer's business premises (sec. 119). Also, under the Tax Reform Act of 1984, the value of the meals provided to an employee at a subsidized eating facility operated by the employer is excluded from income and wages as de minimis fringes if (1) the facility is located on or near the employer's business premises, (2) revenue from the facility equals or exceeds direct operating costs, and (3) in the case of certain highly compensated employees, nondiscrimination requirements are met (sec. 132(e)(2), effective January 1, 1985).

The bill would expand the section 119 exclusion to cover furnishing of meals off the employer's business premises if (1) the employer is unable to justify economically the operation of on-premise facilities, giving due consideration to capital and operating costs, (2) on-premise eating facilities are not provided at the actual place of employment of affected employees, (3) the meals are provided in kind, not in cash, and (4) the meals are furnished within a time frame consistent with the employer's established meal schedule.

The provisions of the bill would be effective on enactment.

3. H.R. 1343—Mr. Lowry

Bad Debt Reserves for Stock Mutual Savings Banks

Under present law, the deduction for reasonable additions to bad debt reserves by thrift institutions with respect to certain real property loans may be limited to 40 percent of taxable income for the year (sec. 593). However, the addition may be limited to less than 40 percent of taxable income to the extent that an insufficient percentage of the taxpayer's total assets consist of real property loans and certain other property (such as cash). The proportion of total assets that must meet this requirement in order for the full 40-percent deduction to apply is 72 percent in the case of mutual savings banks that do not have capital stock represented by shares, and 82 percent in the case of other thrift institutions, including mutual savings banks with capital stock.

The bill would change the application of these rules to mutual savings banks that have capital stock represented by shares. While such institutions are presently subject to the 82-percent asset requirement, the bill would place them instead under the 72-percent requirement. The provisions of the bill would apply to taxable years ending after the date of enactment.

4. H.R. 1773—Messrs. Duncan and Guarini

Exemption from Unrelated Business Income Tax for Sales of Membership Lists By Certain Organizations

Under present law, organizations that are generally exempt from Federal income tax because of their charitable, educational, or religious purposes and functions are subject to tax on any unrelated business taxable income (secs. 511-514). The U.S. Court of Claims held in 1981 that income received by the Disabled American Veterans from other exempt organizations and commercial businesses for the use of mailing lists is subject to the unrelated business income tax (UBIT). Similarly, the IRS has ruled that amounts received by an exempt charitable organization from the regular sale of its membership or mailing lists to business firms and charities are subject to the UBIT.

In the case of any tax-exempt organization which is eligible to receive tax-deductible charitable contributions, the bill would exclude from the tax on unrelated business taxable income any income from exchanging, renting, or selling names and addresses of donors to, or members of, such organization. The provisions of

the bill would be effective for taxable years ending after the date of enactment.

5. H.R. 2129—Messrs. Matsui, Stark, and Thomas

Allocation of Property Taxes Among Tenant-Stockholders in Cooperative Housing Corporations

Under present law, a tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid to the corporation which represents his or her proportionate share of allowable real estate taxes and interest (e.g., mortgage interest) relating to the land and buildings held by the cooperative (sec. 216). A tenant-stockholder's proportionate share of interest or property taxes, for deduction purposes, is equivalent to the portion of total cooperative stock which is owned by the tenant-stockholder. This can lead to the allowance of a deduction which is significantly different from the amount actually attributable to an individual tenant-stockholder's unit in the case of a State (such as California) where property taxes may be assessed based on separate appraisals of individual units.

Under the bill, the amount deductible under section 216 by a tenant-stockholder in a State which uses such separate appraisals would reflect the amount of property tax actually attributable to his or her unit, rather than his or her portion of total stock. Thus, the deduction allowed under section 216 would reflect the tenant-stockholder's proportionate share of the cooperative's real estate expenses in States where different units are appraised separately.

The provisions of the bill would apply retroactively for taxable years beginning after 1982.

6. H.R. 2686—Messrs. Guarini, Stark, and Frenzel

Business Development Companies

Under present law, a business development company within the meaning of section 2(a)(48) of the Investment Company Act of 1940 cannot qualify as a regulated investment company ("RIC"). The bill would alter the definition of a RIC so that business development companies (other than personal holding companies) could qualify for RIC status.

The provisions of the bill would apply retroactively to taxable years beginning on or after October 21, 1980.

7. H.R. 3284—Messrs. Jenkins and Hance

Deduction for Loss in Value of Bus Operating Authorities

Under present law, courts have denied an ordinary loss deduction (sec. 165) where the value of an operating permit or license decreased as a result of legislation expanding the number of issued licenses or permits. In 1981, as a result of the deregulation of the trucking industry, the Congress enacted a tax provision that allows trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the Economic Recovery Tax Act of 1981).

The owners of bus operating authorities assert that they face a situation similar to that faced by the trucking industry, arguing that the value of bus operating authorities has diminished significantly as a result of Federal legislation that deregulated the intercity bus industry. The bill would provide tax deductions for the owners of bus operating authorities generally similar to those granted in 1981 with respect to motor carrier authorities.

The provisions of the bill would apply retroactively to taxable years ending after November 18, 1982.

8. H.R. 3388—Messrs. Matsui, Thomas, and Fazio

Application of Section 252 of Economic Recovery Tax Act of 1981 to Certain Transfers in 1973

The bill would permit certain individuals who received stock in 1973 pursuant to the exercise of employee stock options to elect to have section 252 of the Economic Recovery Tax Act of 1981 apply retroactively in certain limited circumstances. Under the bill, any reduction in tax pursuant to such election could not exceed $100,000 with respect to any one employee. The statute of limitations would be amended by the bill to permit refunds or credits, or assessments, attributable to the provisions of the bill.

9. H.R. 3528—Mrs. Kennelly

Deduction for Loss in Value of Freight Forwarder Operating Authorities

Under present law, courts have denied an ordinary loss deduction (sec. 165) where the value of an operating permit or license decreased as a result of legislation expanding the number of issued licenses or permits. In 1981, as a result of the deregulation of the trucking industry, the Congress enacted a tax provision that allows trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the Economic Recovery Tax Act of 1981).

The owners of freight forwarder operating authorities assert that they face a situation similar to that faced by the trucking industry, arguing that the Interstate Commerce Commission no longer subjects their industry to significant entry restrictions. The bill would expand the scope of the 1981 tax provision to apply to freight forwarder operating authorities.

The provisions of the bill would apply retroactively to taxable years ending after June 30, 1980.

10. H.R. 4167—Messrs. Jenkins, Fowler, and Gephardt, Mrs. Kennelly, Messrs. Matsui, Flippo, Anthony, Philip Crane, Archer, Moore, Duncan, Pickle, Hance, Vander Jagt, Dorgan, Campbell, Heftel, and others

Exemption from Unrelated Business Income Tax for Income from Certain Oil and Gas Property

Under present law, most organizations that generally are exempt from Federal income taxation under Code section 501(a), including

any trust that is part of a tax-qualified pension, profit-sharing, or stock bonus plan (qualified pension plan) described in section 401(a), are subject to tax on any unrelated business taxable income (secs. 511-514). In addition, a tax is imposed on the unrelated trade or business income of an individual retirement account or annuity (an IRA).

Under the bill, certain tax-exempt organizations would be permitted to invest in limited partnerships owning working interests in domestic oil and gas properties without incurring tax for unrelated business income. Eligible organizations under the bill would include exempt trusts that are part of tax-qualified pension plans, IRAs, and certain tax-exempt educational organizations. The provisions of the bill would apply retroactively for partnership taxable years beginning after 1982.

11. H.R. 4507—Messrs. Foley, Rangel, and Stark, and Mrs. Kennelly

Allowance of Investment Tax Credit to Members of Certain Tax-Exempt Religious Organizations

Section 501(d) provides an income tax exemption for a religious or apostolic organization if (1) it has a common treasury or community treasury, even if it engages in business for the common benefit of the members, and (2) its members include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the organization's taxable income for such year.

The Code allows an investment tax credit for certain acquisitions of depreciable property. In the case of such property used by a tax-exempt organization, however, the credit is not allowed unless the property is used in an unrelated trade or business the income of which is subject to tax under section 511 (sec. 48(a)(4)). The Ninth Circuit has ruled that since a section 501(d) organization is not subject to the section 511 tax on unrelated business taxable income, neither the organization nor its members on their tax returns could claim the investment tax credit for depreciable property acquired by the organization.

Under the bill, depreciable property acquired by an eligible section 501(d) organization for use in a business conducted for the common benefit of its members would give rise to an investment tax credit. The amount of such qualified investment by a section 501(d) organization would be apportioned pro rata among its members in the same manner as its taxable income is allocated. The provisions of the bill would apply only if the section 501(d) organization has been in existence for if more than five years, or if more than one-half its members have been members for more than five years of any tax-exempt section 501(d) organization or of any religious community which is part of a tax-exempt organization described in section 501(c)(3).

The provisions of the bill would apply retroactively to periods after 1978.

12. H.R. 4779—Messrs. Thomas, Lagomarsino, Pashayan, and McCandless

Exemption from Windfall Profit Tax for Certain Production

Present law imposes a windfall profit tax on crude oil that is removed from the premises on which it is produced (secs. 4986 et seq.). The bill would provide a limited exemption for crude oil which is exchanged for residual fuel oil that is used to power enhanced recovery processes, effective for residual fuel used, and crude oil removed, after the date of enactment.

13. H.R. 5022—Mr. Stark

Denial of Percentage Depletion for Income From Certain Lease Bonuses or Royalites

Present law imposes a 1,000 barrel a day limitation on percentage depletion with respect to oil and gas production of independent producers and royalty owners (sec. 613A). Under a recent Supreme Court decision, this limitation may not apply in the case of advance royalties.

The bill would deny percentage depletion with respect to any income from lease bonus, advance royalty, or other amounts payable without regard to actual production from a property, effective January 1, 1984.

14. H.R. 5199—Mr. Stark

Applicability of Farming Syndicate Rules of Section 278(b) to Inedible Fruits and Nuts

Under present law, farming syndicates must capitalize the costs of planting, cultivating, maintaining, and developing certain groves, orchards, and vineyards in which fruit or nuts are grown, if the costs are incurred before the grove, orchard, or vineyard bears a crop or yield in commercial quantities (sec. 278(b)). It is unclear whether these rules apply in the case of inedible fruits or nuts.

The bill would provide that the rules under section 278(b) relating to certain capital expenditures of farming syndicates apply in the case of inedible fruits and nuts, effective for amounts paid or incurred after March 20, 1984.

II. DESCRIPTION OF THE BILLS

1. H.R. 700—Messrs. Stark and Hance Special Deduction Rule for Travel and Transportation Expenses of Construction Workers

Present Law

Present law allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business (Code sec. 162). Traveling expenses which meet these general requirements are deductible if incurred by the taxpayer while he or she is away from home in the pursuit of a trade or business. For these purposes, traveling expenses include transportation fares as well as amounts expended for meals and lodging, other than amounts which are lavish or extravagant under the circumstances (sec. 162(a)(2); Treas. Reg. sec. 1.162-2(a)). No deduction is allowed for personal, living, or family expenses, including the cost of commuting to and from work (sec. 262; Treas. Reg. sec. 1.262-1(b)(5)).

Traveling expenses are considered to be incurred while away from home in several different situations. One such situation is when the traveling expenses are incurred in connection with temporary employment and the taxpayer has a regular or principal place of business (or, in its absence, a regular place of abode) away from which the temporary employment takes place. The term temporary from this purpose generally is defined by the Internal Revenue Service and the majority of courts to mean employment which can reasonably be expected to last only for a short period of time. By contrast, traveling expenses incurred in connection with employment which is considered to be of indefinite or indeterminate duration generally are not deductible. On numerous occasions, the courts have considered the issue of whether a particular taxpayer's employment is temporary or indefinite in nature.

Explanation of the Bill

The bill would provide that a job at a site located more than 30 miles from the principal place of residence of a construction worker shall be deemed to be temporary for the first two years the worker is employed at that job. Accordingly, even if the employment could be considered to be of indefinite duration, the worker would be allowed to deduct travel and transportation expenses (including meals and lodging) for the first two years at a job site which is located more than 30 miles from his or her home.

The bill also would provide that after a construction worker's first two years at such a site, the determination of whether the job was temporary (so that travel and transportation expenses would still be deductible) is to be made on the basis of all the facts and circumstances, subject to three special rules set forth in the bill.

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First, the fact the job had already lasted two years could not be considered in determining whether or not it was temporary. Second, the mere fact that a construction worker's employment at a job site was of indefinite duration could not result in treating the job as other than temporary. Third, no length of time could be deemed, either automatically or presumptively, to make the job other than temporary.

The special traveling expense rules in the bill would apply to any individual employed in the building or construction industry (other than clerical or management employees), whether as a skilled, semi-skilled, or unskilled laborer.

Effective Date

The provisions of the bill would be effective on enactment.

Revenue Effect

The provisions of the bill are estimated to decrease fiscal year budget receipts by $64 million in 1985, $432 million in 1986, $477 million in 1987, $524 million in 1988, and $571 million in 1989.

2. H.R. 907—Mr. Vander Jagt

Expansion of Exclusion for Employer-Provided Meals to Cover Certain Off-Premises Meals

Present Law

Present law excludes from gross income the value of meals furnished to an employee (or to the employee's spouse or dependents) by or on behalf of the employer for the convenience of the employer but only if the meals are furnished on the employer's business premises (sec. 119). If it is reasonable to believe that the employee will be able to exclude the value of a meal from income under section 119, then the value of the meal is not subject to social security or unemployment taxes (secs. 3121(a)(19), 3306(b)(14)).

Under the Tax Reform Act of 1984, the value of meals provided to an employee at a subsidized eating facility operated by the employer is excluded from income and wages as de minimis fringes if (1) the facility is located on or near the employer's business premises, (2) revenue from the facility equals or exceeds direct operating costs, and (3) in the case of certain highly compensated employee's nondiscrimination requirements are met (sec. 132(e)(2), effective January 1, 1985).

Explanation of the Bill

The bill would expand the section 119 exclusion to cover furnishing of meals off the employer's business premises if (1) the employer is unable to justify economically the operation of on-premise eating facilities, giving due consideration to capital and operating costs, (2) on-premise eating facilities are not provided at the actual place of employment of affected employees, (3) the meals are provided in kind, not in cash, and (4) the meals are furnished within a

time frame consistent with the employer's established meal schedule.

Effective Date

The provisions of the bill would be effective on enactment.

Revenue Effect

The provisions of the bill are estimated to decrease fiscal year budget receipts by $111 million in 1985, $194 million in 1986, $249 million in 1987, $287 million in 1988, and $320 million in 1989.

3. H.R. 1343—Mr. Lowry

Bad Debt Reserves for Stock Mutual Savings Banks

Present Law

Under present law (sec. 593), mutual savings banks, savings and loan associations, and certain other financial institutions ("thrift institutions") can deduct from taxable income a reasonable addition to their reserves for losses on qualifying real property loans (such as home mortgages). The amount so added to a reserve for such losses cannot exceed the largest of three amounts determined under three separate methods—the percentage of taxable income method (sec. 593(b)(2)), the percentage method applicable to banks (sec. 593(b)(3)), and the experience method (sec. 593(b)(4)).

The amount determined under the percentage of taxable income method generally cannot exceed 40 percent of the taxpayer's taxable income for the year. However, because the deduction under section 593(b) is designed in part to encourage financial institutions to provide real property loans, the percentage of taxable income determined under paragraph (2) is reduced to the extent that an insufficient percentage of the taxpayer's holdings consist of real property loans and certain other assets (such as cash) described in section 7701(a)(19)(C) ("qualified property").

In the case of mutual savings banks that do not have capital stock represented by shares, at least 72 percent of total assets must be qualified property in order for the addition to the bad debt reserve, as determined under section 593(b)(2)(B), to equal 40 percent of taxable income for the year. If less than 72 percent of their assets are qualified property, then the 40-percent cap on the addition to the bad debt reserve is reduced by 1½ percentage points for each one percentage point by which an insufficient proportion of total assets so qualify.

A more stringent rule regarding the holding of real property loans applies to all other thrift institutions (including mutual savings banks that have capital stock represented by shares). For these institutions, the full 40-percent cap applies only if at least 82 percent of total assets are qualified property. For each one percentage point by which an insufficient proportion of assets so qualify, the 40-percent cap is reduced by 3/4 of one percentage point.

Explanation of the Bill

Under the bill, mutual savings banks that have capital stock represented by shares would be treated like other mutual savings banks, rather than like all other thrift institutions, for purposes of the permissible addition to bad debt reserves under the percentage of taxable income method. Thus, only 72 percent of the total assets of a stock mutual savings bank, rather than 82 percent as under present law, would have to be qualified property in order for the 40-percent cap, rather than a reduced cap, to apply.

Effective Date

The bill would apply to taxable years ending after the date of enactment.

Revenue Effect

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $50 million annually.

4. H.R. 1773—Messrs. Duncan and Guarini

Exemption from Unrelated Business Income Tax for Sales of Membership Lists by Certain Organizations

Present Law

General rule

Under present law, certain organizations are generally exempt from Federal income tax because of their charitable, educational, religious, or other nonprofit purposes and functions. However, in light of examples of tax-exempt organizations which had been acquiring and operating, on a tax-free basis, businesses unrelated to their exempt purposes or functions, the Congress enacted the unrelated business income provisions in 1950. These provisions (Code secs. 511-514) impose a tax on the unrelated business income of exempt organizations, primarily in order to remove any unfair advantage which tax-exempt organizations otherwise would have over taxable competitors (S. Rep. No. 2375, 81st Cong., 2d Sess. 28-29 (1950)).

The tax applies to gross income derived by an exempt organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business, both subject to certain modifications. Under one such modification (sec. 512(b)(2)), dividends, interest, annuities, royalties, and, generally, rents from real property are exempted from the tax. Also, there are special rules with regard to rents from personal property leased with real property.

Definition of unrelated business

Under present law, an unrelated trade or business is defined as any trade or business of a tax-exempt organization the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its

charitable, educational, religious, or other nonprofit purpose and function constituting the basis for its exemption (sec. 513(a)).

The U.S. Court of Claims held in 1981 that income received by the Disabled American Veterans from other exempt organizations and commercial businesses for the use of its mailing lists constitutes unrelated business taxable income, and does not constitute "royalties" expressly exempted from the tax under section 512(b)(2) (*Disabled American Veterans* v. *U.S.*, 650 F.2d 1128 (1981)). The court found that in renting its donor lists, the DAV operated in a competitive, commercial manner with respect to taxable firms in the direct mail industry; that these rental activities were regularly carried on; and that the rental activities were not substantially related to accomplishment of exempt purposes (apart from the organization's need for or use of funds derived from renting the mailing lists).

Explanation of the Bill

In the case of any organization exempt from tax under section 501 which is eligible to receive tax-deductible charitable contributions under section 170, the bill would exclude from the term unrelated trade or business any trade or business of such organization that consists of exchanging, renting, or selling names and addresses of donors to, or members of, such organization. The categories of organizations to which the bill would apply would include (1) tax-exempt charitable, educational, religious, etc. organizations formed in the United States; (2) certain organizations of war veterans and their auxiliary units; and (3) certain domestic fraternal organizations (which are eligible to receive tax-deductible contributions for gifts is used exclusively for charitable, educational, religious, etc., purposes); and (4) certain nonprofit cemetery companies.

Effective Date

The provisions of the bill would apply to taxable years ending after the date of enactment.

Revenue Effect

The provisions of the bill are estimated to reduce budget receipts by $10 million annually.

Prior Congressional Action

H.R. 4170 (the Deficit Reduction Act of 1984), as passed by the Senate, included a provision (adopted as a floor amendment by Senator Pryor) providing an exemption from the unrelated business income tax for amounts received by certain Federally chartered corporations (named in 36 U.S. Code sec. 1101) for renting or exchanging lists of their donors or members with organizations con-

tributions to which are eligible for charitable deductions. This provision was deleted from the bill in conference.

5 H.R. 2129—Messrs. Matsui, Stark, and Thomas

Allocation of Property Taxes Among Tenant-Stockholders in Cooperative Housing Corporations

Present Law

Taxation of housing cooperatives

Under present law (sec. 216), a tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid to the cooperative which represent his or her proportionate share of allowable real estate taxes and interest (e.g., mortgage interest) relating to the land and buildings held by the cooperative. In general, for a cooperative to qualify for this pass-through treatment, (1) each stockholder of the cooperative must be entitled to occupy a house or apartment owned or leased by the cooperative, (2) no stockholder may receive any distribution from the cooperative (other than distributions out of earnings and profits) except on a liquidation of the cooperative, and (3) tenant-stockholders qualifying for pass-through treatment must have paid amounts for their stock which bear a reasonable relationship to the value of that portion of the cooperative's land and building which is attributable to their house or apartment.

To qualify for pass-through treatment, 80 percent or more of the cooperative's gross income must be derived from tenant-stockholders. For purposes for this rule, as well as the rules above, tenant-stockholders are generally limited to individuals. Thus, corporations, trusts, and other similar entities generally do not qualify for pass-through treatment. Limited exceptions to this rule are provided for certain original sellers of property to a cooperative and for banks or other lending institutions which acquire cooperative stock by foreclosure.

In addition to being allowed deductions for rent and taxes, and to the extent a tenant-stockholder uses depreciable property leased from the cooperative in a trade or business or for production of income, the tenant-stockholder is allowed a deduction with respect to the stock the ownership of which entitles him or her to lease the property. This deduction generally cannot exceed that portion of the taxpayer's adjusted basis for the stock which is allocable to the depreciable property.

Allocation of property taxes

Under present law, a tenant-stockholder's proportionate share of interest or property taxes, for deduction purposes, is equivalent to the portion of total cooperative stock which is owned by the tenant-stockholder. This rule applies even if property taxes are imposed on certain tenant-stockholders out of proportion to the value of their cooperative stock (e.g., under certain California property

taxes which are assessed based on separate appraisals of individual cooperative units).[1] In such cases, individual tenant-stockholders may be allowed a deduction which is significantly less than (or greater than) the amount of real estate taxes attributable to their property.

Explanation of the Bill

The bill would provide that, if State or local law (or ordinance) requires an allocation of property taxes based on separate appraisal of some or all of the individual units in a housing cooperative, the proportionate share of such taxes for deduction purposes is to be the amount allocated to those units pursuant to such law or ordinance. Thus, property tax deductions would be allocated among the tenant-stockholders according to the actual amount of such taxes attributable to the property of each tenant-stockholder. For example, if in Year 1 all units in a housing cooperative were appraised at the same value for State property tax purposes, but in Year 2 several of the units were given a higher appraisal, then in Year 1 all tenant-stockholders (owning equal shares) would generally be entitled to deduct the same proportionate share of real estate taxes, while in Year 2 the proportionate share allocable to those in reappraised units would be increased, and the proportionate share allocable to those in other units would be decreased, in accordance with the reappraisals.

Effective Date

The bill would be effective retroactively for taxable years beginning after December 31, 1982.

Revenue Effect

The provisions of the bill are estimated to reduce budget receipts by less than $10 million annually.

Prior Congressional Action

H.R. 4170 the (Deficit Reduction Act of 1984) as passed by the Senate, included a similar provision (adopted as a floor amendment by Senator Wilson). This provision (together with other amendments which would have affected cooperative housing corporations) was deleted from the bill in conference.

6. H.R. 2686—Messrs. Guarini, Stark and Frenzel

Business Development Companies

Present Law

Overview

Income-producing assets can be owned directly, or can be owned indirectly by means of an equity interest in an intermediary entity.

[1] As a result of Proposition 13, California property tax assessments may generally be increased only upon resale of a unit. Thus, proportionately higher taxes are imposed on units which have been resold.

Income generated by property that is owned directly is generally taxed to the owner of the property and therefore is subject to only one level of taxation. Income from property owned indirectly in an intermediary entity is subject to one or two levels of taxation depending on whether the intermediary entity is treated for tax purposes as (1) a separate taxable entity (such as a corporation or an association taxable as a corporation), (2) a complete conduit entity (such as a partnership or S corporation), or (3) as a partial conduit entity (such as a real estate investment trust) under which income is not taxed to the extent it is currently distributed to the entity's owners. A regulated investment company ("RIC") is a partial conduit entity.

RICs

RICs are domestic corporations that issue shares to investors and invest the proceeds in diversified portfolios of securities. Under the RIC provisions of the Code, a RIC is generally treated as a conduit for tax purposes. This is accomplished by allowing a RIC a deduction for income that is distributed to its shareholders on a current basis. Income that is not distributed on a current basis is taxed at the RIC level as in the case of a normal corporation. The original purpose of the RIC provisions was to permit small investors to obtain the benefits of investment diversification and professional management by making passive investments through a widely held vehicle without subjecting the profits derived from the investment to a second level of taxation.

Requirements for RIC status

A RIC is a domestic corporation that (1) is registered with the Securities and Exchange Commission at all times during the taxable year as a management company or a unit investment trust under the Investment Company Act of 1940, or (2) is a common trust fund or similar fund that is not a "common trust fund" under the Internal Revenue Code and which is excluded by the Investment Company Act from the definition of investment company. Under present law, a business development company within the meaning of section 2(a)(48) of the Investment Company Act does not qualify as a RIC.

Business development companies

Under the Small Business Incentive Act of 1980, certain investment companies providing capital and managerial assistance to small business may elect to be treated as "business development companies" in lieu of registering under the Investment Company Act.

Explanation of the Bill

Under the bill, a business development company within the meaning of section 2(a)(48) of the Investment Company Act of 1940, as amended, other than a business development company that is a personal holding company,[2] could qualify as a RIC.

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[2] The prohibition against personal holding companies qualifying as RICs generally was repealed by section 1071 of the Tax Reform Act of 1984 (P.L. 98-369).

Effective Date

The bill would apply in taxable years beginning on or after October 21, 1980.

Revenue Effect

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $50 million annually.

7. H.R. 3284—Messrs. Jenkins and Hance

Deduction for Loss in Value of Bus Operating Authorities

Background

Prior to enactment of the Bus Regulatory Reform Act of 1982, intercity bus operators were required to obtain a bus operating authority before providing service on a particular route. Only a limited number of bus operating authorities were issued. Persons wishing to enter a route often purchased an existing business that already owned an operating authority, and substantial amounts were paid for these operating authorities. Thus, the value of bus operating rights constituted a substantial part of a bus operator's assets and a source of loan collateral.

The 1982 statute, in deregulating intercity buses, allows intercity bus operators to enter on, expand, drop, or change routes, free of Federal barriers. As a result of the relative ease of entry into the intercity bus business, the value of bus operating authorities has diminished significantly.

The owners of bus operating authorities state that their situation is similar to that faced by owners of motor carrier operating authorities after enactment of the Motor Carrier Act of 1980. That statute deregulated the trucking industry; as a result, motor carrier operating authorities lost significant value. In the Economic Recovery Tax Act of 1981, the Congress enacted a provision allowing trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the 1981 Act).

Present Law

A deduction is allowed for any loss incurred in a trade or business during the taxable year, if the loss is not compensated for by insurance or otherwise (Code sec. 165(a)). In general, the amount of the deduction equals the adjusted basis of the property giving rise to the loss (sec. 165(b)). Treasury regulations provide that, to be deductible, a loss must be evidenced by a closed and completed transaction (i.e., must be "realized"), and must be fixed by an identifiable event (Treas. Reg. sec. 1.165-1(b)).

As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition. Thus, for a loss to be allowed as a deduction, generally the business must be discontinued or the property must be abandoned (Treas. Reg. sec. 1.165-2)). Further, if the property is a capital asset and is sold

or exchanged at a loss, the deduction of the resulting capital loss is subject to limitations (secs. 1212, 1211, and 165(f)).

The courts have denied a loss deduction where the value of an operating permit or license decreased as the result of legislation expanding the number of licenses or permits that could be issued. In the view of several courts,[3] the diminution in the value of a license or permit does not constitute an event giving rise to a deductible loss if the license or permit continues to have value as a right to carry on a business.

Explanation of the Bill

The bill would allow an ordinary deduction ratably over a 60-month period for taxpayers who held one or more bus operating authorities on November 19, 1982 (the date of enactment of the Bus Regulatory Reform Act of 1982). The amount of the deduction would be the aggregate adjusted bases of all bus operating authorities that were held by the taxpayer on November 19, 1982, or acquired after that date under a contract that was binding on that date.

The maximum amount of basis that could be taken into account with respect to all bus operating authorities held by a taxpayer would be limited to $5 million.

The 60-month period would begin with the later of the month of November, 1982, or, at the taxpayer's election, the first month of the taxpayer's first taxable year beginning after that date. The bill would require that adjustments be made to the bases of authorities to reflect amount allowable as deductions under the bill.

Under regulations to be prescribed by the Treasury, a taxpayer (whether corporate or noncorporate) holding an eligible bus operating authority would be able to elect to allocate to the authority a portion of the cost to the taxpayer of stock in an acquired corporation. The election would be available if the bus operating authority was held (directly or indirectly) by the taxpayer at the time its stock was acquired. In such a case, a portion of the stock basis would be allocated to the authority only if the corporate or noncorporate taxpayer would have been able to make such an allocation had the authority been distributed in a liquidation to which prior law section 334(b)(2) applied. The election would be available only if the stock was acquired on or before November 19, 1982 (or pursuant to a binding contract in effect on such date) and if no election under section 338 is in effect.

Effective Date

The provisions would be effective retroactively for taxable years ending after November 18, 1982.

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[3] See, *e.g.*, *Consolidated Freight Lines, Inc.* v. *Comm'r*, 37 B.T.A. 576 (1938), *aff'd* 101 F.2d 813 (9th Cir.), *cert. denied*, 308 U.S. 562 (1939) (denial of loss deduction attributable to loss of monopoly due to State deregulation of the intrastate motor carrier industry); *Monroe W. Beatty*, 46 T.C. 835 (1966) (no deduction allowed for diminution in value of liquor license resulting from change in State law limiting grant of such licenses).

Revenue Effect

The provisions of the bill are estimated to reduce fiscal year budget receipts by $7 million in 1985, $6 million in 1986, $3 million in 1987, $1 million in 1988, and a negligible amount in 1989.

8. H.R. 3388—Messrs. Matsui, Thomas, and Fazio

Application of Section 252 of Economic Recovery Tax Act of 1981 to Certain Transfers in 1973

Present Law

In general

Under the present law rules relating to transfers of property in connection with the performance of services (sec. 83), an employee generally includes in income the fair market value of transferred property, less any amount paid for the property, when the property first becomes either transferable or not subject to a substantial risk of forfeiture.[4] Thus, if an employee receives property that is both subject to a substantial risk of forfeiture and is not transferable, the employee generally is not taxed until the property becomes either transferable or not subject to a substantial risk of forfeiture. The amount the employee includes in income is equal to the fair market value of the transferred property (as of the time of taxation), less any amount the employee paid for the property.

However, an employee may elect (under sec. 83(b)) to be taxed when the property is received. In that case, the employee includes an amount in income equal to the fair market value of the property when received less any amount paid for the property.

Effect of restrictions

Generally, under section 83, restrictions on property are not taken into account in determining the fair market value of the property. Also, property is considered transferable for purposes of section 83 when the property would not be subject to a substantial risk of forfeiture in the hands of a subsequent transferee.

Prior to enactment of section 252 of the Economic Recovery Tax Act of 1981 (ERTA), the U.S. Tax Court had ruled [5] that stock subject to the "insider trading" rules of section 16(b) of the Securities Exchange Act of 1934 [6] was transferable within the meaning of section 83. Thus, although the taxpayer's profit on a sale of the stock within six months of receipt could be recovered by the corporation, the taxpayer was taxable on the fair market value of the stock when received.

As amended by section 252 of ERTA, section 83 provides that stock subject to the restrictions of section 16(b) of the Securities Exchange Act of 1934 is treated as being subject to a substantial risk of forfeiture and nontransferable for the six-month period following receipt of the stock during which that section applies. Thus, unless

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[4] An employer generally is allowed a business expense deduction, when the employee is taxed, equal to the amount includible in the employee's income (sec. 83(h)).

[5] *Horwith* v. *Comm'r*, 71 T.C. 932 (1979).

[6] 15 U.S.C. sec. 78p(b).

the taxpayer elects (under sec. 83(b)) to be taxed when the stock is received, the taxpayer must include in income (and the employer may deduct), at the expiration of the period during which section 16(b) is applicable, the value of the stock at such time, less any amount the taxpayer paid for the stock. A similar rule is provided for stock subject to restrictions on transfer by reason of complying with the "pooling-of-interests" accounting rules of Accounting Series Releases Numbered 130 (10/5/72) 37 FR 20937; 17 CFR 211.130)) and 135 ((1/18/73) 38 FR 1734; CFR 211.135)).

The amendments made to section 83 by section 252 of ERTA apply to taxable years (of the transferee) ending after December 31, 1981.

Explanation of the Bill

Under the bill, the rules of section 252 of ERTA would apply if (1) stock was acquired in November or December of 1973 pursuant to options granted in November or December of 1971, (2) the corporation granting the options was acquired in a reorganization during December 1973, and (3) the fair market value of the stock in the acquiring corporation as of July 1, 1974, received in exchange for the stock acquired on exercise of the option, was less than 50 percent of its value on December 4, 1973. This relief under the bill would be allowed only at the election of a shareholder who during 1975 or 1976 sold substantially all the stock so received.

The bill would not apply with respect to a transfer to any employee to the extent that its application would result in a reduction in tax liability (exclusive of interest) of such employee in excess of $100,000 for all taxable years.

Also, the bill provides that a refund or credit of any overpayment of tax, or an assessment of any deficiency, which is attributable to provisions of the bill, and which otherwise would be barred within six months after the date of enactment, could be made or allowed to the extent attributable to application of provisions of the bill, provided that, in the case of a credit or refund, a claim therefor is filed within such six-month period.

The provisions of the bill could affect the tax liability of an electing person for the year in which stock was sold, as well as the amount of compensation and the year of its inclusion in income. The bill could also affect the amount and timing of any deduction allowable to the employer corporation. The statute of limitations would be kept open for the purpose of making such adjustments.

The intended beneficiaries of the bill are John G. Franzia, Jr., Joseph S. Franzia, and Fred T. Franzia.

Effective Date

The bill would have only retroactive effect, and only to the limited extent provided in the bill and described in the explanation of the provisions of the bill.

Revenue Effect

The provisions of the bill are estimated to have a negligible effect on budget receipts.

Prior Congressional Action

An identical bill in the 97th Congress (H.R. 4577) passed the House and was favorably reported by the Senate Finance Committee, but was not enacted.

9. H.R. 3528—Mrs. Kennelly

Deduction for Loss in Value of Freight Forwarder Operating Authorities

Background

Freight forwarders are required to obtain an operating authority before providing services. Historically, only a limited number of freight forwarder operating authorities were issued. Thus, the value of an operating authority constituted a substantial part of a freight forwarder's assets. Since 1980, however, the Interstate Commerce Commission (the "ICC") has granted operating authorities to freight forwarders without regard to the prior scheme of economic regulation. Nor have freight forwarders been subjected to any significant regulatory entry restrictions. As a result of the relative ease of entry into the freight forwarding business, the value of freight forwarder operating authorities has diminished significantly.

Although the Congress has not acted to deregulate the freight forwarding industry, the owners of freight forwarder operating authorities state that their situation is similar to that faced by owners of motor carrier operating authorities after enactment of the Motor Carrier Act of 1980. That statute deregulated the trucking industry; as a result, motor carrier operating authorities lost significant value. The Economic Recovery Tax Act of 1981 contained a provision that allows trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the 1981 Act).

Present Law

A deduction is allowed for any loss incurred in a trade or business during the taxable year, if the loss is not compensated for by insurance or otherwise (Code sec. 165(a)). In general, the amount of the deduction equals the adjusted basis of the property giving rise to the loss (sec. 165(b)). Treasury regulations provide that, to be deductible, a loss must be evidenced by a closed and completed transaction (i.e., must be "realized"), and must be fixed by an identifiable event (Reg. sec. 1.165-1(b)).

As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition. Thus, for a loss to be allowed as a deduction, generally the business must be discontinued or the property must be abandoned (Reg. sec. 1.165-2)). Further, if the property is a capital asset and is sold or exchanged at a loss, the deduction of the resulting capital loss is subject to limitations (secs. 1212, 1211, and 165(f)).

The courts have denied a loss deduction where the value of an operating permit or license decreased as the result of legislation expanding the number of licenses or permits that could be issued. In

the view of several courts,[7] the diminution in the value of a license or permit does not constitute an event giving rise to a deductible loss if the license or permit continues to have value as a right to carry on a business.

Explanation of the Bill

The bill would expand the scope of section 266 of the 1981 Act to allow an ordinary deduction ratably over a 60-month period for taxpayers who held one or more freight forwarder operating authorities on July 1, 1980 (the date of enactment of the Motor Carrier Act of 1980). The amount of the deduction would be the aggregate adjusted bases of all freight forwarder operating authorities that were held by the taxpayer on July 1, 1980, or acquired after that date under a contract that was binding on that date.

The 60-month period would begin with the later of July 1, 1980, the month in which acquired, or at the taxpayer's election, the first month of the taxpayer's first taxable year beginning after that date. The bill would require that adjustments be made to the bases of authorities to reflect amounts allowable as deductions under the bill.

Under regulations to be prescribed by the Treasury, a corporate taxpayer holding an eligible operating authority would be able to elect to allocate to the authority a portion of the cost to the taxpayer of stock in an acquired corporation (see Treas. Reg. sec. 1.9200-1 for rules relating to motor carrier operating authorities). The election would be available if the operating authority was held (directly or indirectly) by the taxpayer at the time its stock was acquired. In such a case, a portion of the stock basis would be allocated to the authority only if the corporate taxpayer would have been able to make such an allocation had the authority been distributed in a liquidation to which prior-law section 334(b)(2) applied. The election would be available only if the stock was acquired on or before July 1, 1980 (or pursuant to a binding contract in effect on such date).

Effective Date

The provisions of the bill would be effective retroactively for taxable years ending after June 30, 1980.

Revenue Effect

The provisions of the bill are estimated to decrease fiscal year budget receipts by $20 million in 1985 and $13 million in 1986.

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[7] See e.g., *Consolidated Freight Lines, Inc.* v. *Comm'r*, 37 B.T.A. 576 (1938), *aff'd*, 101 F.2d 813 (9th Cir.), *cert. denied*, 308 U.S. 562 (1939) (denial of loss deduction attributable to loss of monopoly due to State deregulation of the intrastate motor carrier industry); *Monroe W. Beatty*, 46 T.C. 835 (1966) (no deduction allowed for diminution in value of liquor license resulting from change in State law limiting grant of such licenses).

10. H.R. 4167—Messrs. Jenkins, Fowler, and Gephardt, Mrs. Kennelly, Messrs. Matsui, Flippo, Anthony, Philip Crane, Archer, Moore, Duncan, Pickle, Hance, Vander Jagt, Dorgan, Campbell, Heftel and others

Exemption from Unrelated Business Income Tax for Income from Certain Oil and Gas Property

Present Law

In general

Under present law, most organizations that generally are exempt from Federal income taxation under Code section 501(a), including any trust that is part of a tax-qualified pension, profit-sharing, or stock bonus plan described in section 401(a), are subject to tax on any unrelated business taxable income (secs. 511–514). In addition, a tax is imposed (sec. 408(e)(1)) on the unrelated trade or business income of an individual retirement account or annuity (an IRA). The term unrelated trade or business generally means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the activities for which the organization is granted tax exemption.

Present law provides that a tax-exempt organization is treated as being engaged in the same activities as any partnership (whether limited or general) in which the organization invests. Accordingly, if a tax-exempt organization becomes a limited partner in a partnership that owns a working interest in oil and gas properties and the working interest is not substantially related to the organization's exempt function, the income derived from the working interest is subject to the unrelated trade or business tax.

Debt-financed property

Present law also provides that the income of an exempt trust or organization, or an IRA, from debt-financed property that is unrelated to its exempt function is subject to the unrelated business income tax in the proportion in which the property is financed by the debt (sec. 514). Debt-financed property means all property (e.g., rental real estate, tangible personal property, and corporate stock) that is held to produce income and with respect to which indebtedness was incurred to acquire or improve the property or an indebtedness would not have been incurred but for the acquisition or improvement of the property.

A special rule applies under present law to real property acquired by an educational organization described in section 170 or a tax-exempt trust forming part of a tax-qualified pension, etc., plan. Under this rule, debt-financed real property acquired by such an educational organization or exempt trust is not treated as debt-financed property unless all of the following applies:

(1) the acquisition is a fixed amount determined as of the date of acquisition;

(2) the amount of any indebtedness or any other amount payable with respect to such indebtedness, or the time for making

any payment with respect to the indebtedness, is not partially or wholly dependent upon any revenue, income, or profits derived from the real property;

(3) the real property is not at any time after acquisition leased by the organization or trust to the seller or to any person related to the seller (within the meaning of sec. 267(b));

(4) the real property is not acquired from, or at any time after acquisition, leased to any person that bears a certain relationship to the organization or the trust;

(5) the seller or any person related to the seller or the organization or trust (as described in (3) or (4)) does not provide the organization or trust with financing in connection with the acquisition; and

(6) in the case of property acquired by a partnership, either (i) all members of the partnership are tax-exempt organizations with no unrelated trade or business income or (ii) all income, deductions, credits, etc., are allocated to the partners in a qualified allocation (within the meaning of sec. 168(j)(9)).

Explanation of the Bill

In general

Under the bill, certain exempt organizations would be permitted to invest in working interests in domestic oil and gas properties without incurring tax for unrelated business income. The organizations that would be eligible under this provision include exempt trusts forming a part of tax-qualified pension plans, IRAs, and tax-exempt educational organizations described in Code sections 170(b)(1)(A)(ii) or 170(b)(1)(A)(iv).

In order to qualify under the special rule of the bill, the trust or organization would have to receive income from the working interest in oil and gas property as a limited partner from a limited partnership. In addition, the limited partnership could not, at any time during the partnership taxable year for which an income allocation is made —

(i) allocate to the limited partners a share of any item of deduction, loss, or credit that is less than the limited partners' share of income or gain;

(ii) allocate among the limited partners any item of deduction, loss, or credit that differs from the ratio in which they share income or gain;

(iii) allocate cash distributions to partners (limited or general) in a manner that differs from the allocation of income or gain.

However, under the bill these restrictions would not apply where the allocations of depreciation, depletion, gain, or loss take account of the variation between the basis of property to the limited partnership and its fair market value at the time of its contribution to the partnership and if the allocations are permissible under Treasury regulations (sec. 704(c)).

For purposes of determining whether an exempt trust or organization is a limited partner or a general partner in a limited partnership, the interests of certain related parties would be taken into account. In addition, an exempt trust or organization that is a lim-

ited partner would be treated as owning an interest in any general partner held by any other exempt trust or organization (including related persons) that is a partner in the partnership.

The bill would authorize the Treasury Department to prescribe regulations that would deny the special treatment under the bill in any case in which multi-tier partnerships or other arrangements are used for the principal purpose of avoiding the conditions of the bill.

Debt-financed property

The bill would provide an exception to the rules relating to debt-financed property for working interests in domestic oil and gas properties acquired by tax-qualified pension plans, IRAs, or certain educational organizations, which would be similar to the rules that apply under present law to investments by certain education organizations or tax-qualified pension plans in debt-financed real property.

Under these rules, the exemption would only apply if the acquisition price is a fixed amount and payments are not dependent upon the profits from the property (items 1 and 2 under present law, above). However, the limitations relating to leases between related parties, acquisitions from related parties, and financing from related parties (items 3, 4, and 5, above) would not apply to any acquisition, lease, farm-out, or other transfer of a working interest to a person related to the general partner if the terms of the transfer are consistent with the terms of similar transfers in the same geographic area. The restrictions on allocations under present law (item 6 above) would not apply, but special allocation rules would be provided (see In general, above).

Effective Date

The provisions of the bill would apply retroactively for partnership taxable years beginning after 1982.

Revenue Effect

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $10 million annually.

11. H.R. 4507—Messrs. Foley, Rangel, and Stark and Mrs. Kennelly

Allowance of Investment Tax Credit to Members of Certain Tax-Exempt Religious Organizations

Present Law

Present law provides an income tax exemption for a religious or apostolic association or corporation if (1) it has a common treasury or community treasury, even if it engages in business for the common benefit of the members, and (2) its members include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the organization's taxable income for such year (sec. 501(d)). Any amount so included in the gross income of a member is treated as a dividend received.

Thus, members of section 501(d) organizations file individual tax returns and pay income tax on their pro rata shares of organization income.

While a nonprofit religious organization may qualify for tax-exempt status under section 501(c)(3) if it meets the requirements of that section, exemption under that provision is not available if the organization is operated for the primary purpose of conducting an unrelated trade or business or otherwise is not operated exclusively for exempt purposes, or if any part of the organization's net earnings inures to the benefit of a private individual. Accordingly, a communal religious organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business cannot qualify for exemption under section 501(c)(3), but could seek to qualify for exemption under section 501(d) if its members included the organization's taxable income on their returns (see Treas. Reg. sec. 1.501(c)(3)-1(e)(1); GCM 38827, March 23, 1982)).

The Code allows an investment tax credit for certain acquisitions of depreciable property (sec. 38(a)). In the case of such property used by a tax-exempt organization, however, the credit is not allowed unless the property is used in an unrelated trade or business the income of which is subject to tax under section 511 (sec. 48(a)(4)). The Ninth Circuit has ruled that since section 501(d) organizations are not subject to the section 511 tax on unrelated business taxable income, neither the organization nor its members on their tax returns can claim the investment tax credit for depreciable property acquired by the organization (*Kleinsasser* v. *U.S.*, 707 F.2d 1024 (9th Cir. 1983)).

Explanation of the Bill

The bill would provide that, for purposes only of the investment credit rules in section 48(a)(4), any business which is conducted by an eligible section 501(d) organization for the common benefit of its members and the taxable income from which is included in the gross income of its members is to be treated as an unrelated business. Accordingly, the acquisition of depreciable property by an eligible section 501(d) organization for use in such a business would give rise to an investment tax credit to the same extent as if the property had been acquired by a section 501(c)(3) organization for use in an unrelated business.

Under the bill, the amount of such qualified investment by a section 501(d) organization would be apportioned pro rata among its members in the same manner as its taxable income is allocated. The bill would not allow any credit for such investment to a member who claimed any other type of investment credit, and would prohibit the reallocation of any such disallowed credit to other community members. The used-property credit limitation and credit recapture rules would apply at the organization level.

The provisions of the bill would apply to any organization which elects to be treated as an organization described in section 501(d) and which is exempt from tax under section 501(a), provided that as of the close of the taxable year either (a) the organization has been in existence for more than five years, or (b) more than one-half its members have been members for more than five years of

any tax-exempt section 501(d) organization or of any religious community which is part of a tax-exempt organization described in section 501(c)(3).

Effective Date

The provisions of the bill would apply retroactively to periods after 1978 (under rules similar to those in Code sec. 48(m)).

Revenue Effect

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $5 million annually.

12. H.R. 4779—Messrs. Thomas, Lagomarsino, Pashayan, and McCandless

Exemption from Windfall Profit Tax for Certain Production

Present Law

Present law imposes an excise tax (a windfall profit tax on domestically produced crude oil when the oil is removed from the premises on which it was produced (secs. 4986 et seq.). If crude oil is used before the tax is imposed, then the windfall profit tax is imposed on that use. The Joint Statement of Managers for the Windfall Profit Tax Act indicated that because of differences in the definition of the word property, a producer could have a single, undivided piece of land which constitutes many DOE "properties," even though they are contiguous and not even divided by a public road. The statement stated that in such a case, "powerhouse" fuel produced on one section of a single undivided piece of land is not taxable if it is used on another section of the same piece of land as powerhouse fuel and never leaves the piece of land on which it is produced. The windfall profit tax treatment of such oil was to have no implication for its treatment for various income tax purposes.[8] Thus, present law does not impose the windfall profit tax on crude oil used as power house fuel on the property from which it was removed. However, present law does impose the windfall profit tax in a case in which the owner of a property delivers its product to a refinery which removes the light hydrocarbons from that oil and returns the residual to the producer for use as fuel in powering production equipment on the property.

Explanation of the Bill

The bill would provide a statutory exemption for certain production which is used to power production equipment on the producer's property. This exempt production oil would be so much of the producer's crude oil as is (1) removed from the property during the calendar quarter, (2) would otherwise be taxable, (3) is attributable to the producer's operating mineral interests, and (4) is exchanged solely for an equal number of barrels of residual fuel oil used by

[8] H.R. Rpt. No. 96-817, 96th Cong., 2d Sess. 105-106.

the producer with respect to the property during that or the succeeding quarter in enhanced recovery processes.

A person's share of residual fuel oil used on the property would be the same as that person's interest in production from the property for the quarter period. The bill would authorize the Treasury to prescribe regulations allocating a person's exempt production among and within the various tiers of taxable crude oil provided by under the windfall profit tax.

For purposes of this exemption, an enhanced recovery process would be any process for increasing the ultimate total recovery of oil from a reservoir by modifying any property of any fluid in the reservoir or any process for displacing or controlling the flow rate or pattern in the reservoir. Enhanced recovery processes would not include any process the sole purpose of which is to aid in lifting fluids to the well bore. Residual fuel oil would be defined to include no. 4, no. 5, or no. 6 fuel oil, Bunker c oil, Navy special fuel oil, or any other fuel which has a 50 percent boiling point in excess of 700 degrees Fahrenheit in the ASTM D-86 standard distillation test. The exemption in the bill would not apply to any oil attributable to nonoperating mineral interests such as royalty interests.

The bill would also provide that no depletion is available with respect to oil exempt from the windfall profit tax under the production oil exception.

Effective Date

The provisions of the bill would apply to residual fuel used and crude oil removed after the date of enactment.

Revenue Effect

The provisions of the bill are estimated to have a negligible effect on budget receipts.

13. H.R. 5022—Mr. Stark

Denial of Percentage Depletion for Income From Certain Lease Bonus or Royalties

Present Law

In the Tax Reduction Act of 1975, the Congress repealed the percentage depletion allowance for oil and gas production except with respect to limited quantities produced by independent producers and royalty owners. Effective January 1, 1984, the rate for percentage depletion on oil and gas produced by independents and royalty owners declined to a permanent level of 15 percent and the depletable quantity of oil and gas was limited to 1,000 barrels per day.

Following the 1975 depletion amendments, disagreement arose over the treatment of amounts paid in advance of production (i.e., bonuses and advance royalties). The Internal Revenue Service argued that the 1975 Act tied percentage depletion to actual production and, therefore, denied percentage depletion with respect to bonus and advance royalties paid prior to the start of production. In January, 1984, the Supreme Court held that a bonus or advance royalty paid to a lessor in a year in which no oil or gas is produced

is subject to percentage depletion notwithstanding the 1,000 barrel per day limitation *(Comm'r* v. *Engle*, 104 S.Ct. 597 (1984)). The Court left open the possibility that the Treasury Department could promulgate regulations giving effect to the limitation by limiting the period in which depletion may be claimed. The extent of this possible regulatory authority is unclear.

Explanation of the Bill

The bill would provide that no percentage depletion may be claimed with respect to gross income from any lease bonus, advance royalty, or other amount payable without regard to actual production from the property.

Effective Date

This amendment would take effect on January 1, 1984.

Revenue Effect

The provisions of the bill are estimated to increase fiscal year budget receipts by $336 million in 1985, $253 million in 1986, $249 million in 1987, $234 million in 1988, and $215 million in 1989.

14. H.R. 5199—Mr. Stark

Applicability of Farming Syndicate Rules of Section 278(b) to Inedible Fruits and Nuts

Present Law

Under present law, farming syndicates must capitalize the costs of planting, cultivating, maintaining, and developing certain groves, orchards, and vineyards in which fruit or nuts are grown, if the costs are incurred before the grove, orchard, or vineyard bears a crop or yield in commercial quantities (sec. 278(b)). The costs that are required to be capitalized include any amount which would be allowable as a deduction but for this provision. An exception to this capitalization rule is provided for amounts otherwise allowable as deductions which are attributable to a grove, orchard, or vineyard which is replanted after having been lost or damaged while in the hands of the taxpayer by reason of freezing temperatures, disease, drought, pests, or casualty.

A farming syndicate is defined generally as including (1) a partnership or other enterprise (other than a corporation which is not an S corporation) engaged in the trade or business of farming if, at any time, interests in the partnership or other enterprise have been offered for sale in an offering required to be registered with a Federal or State agency having authority to regulate the offering of securities for sale, or (2) a partnership or other enterprise (other than a corporation which is not an S corporation) engaged in the trade or business of farming if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs (sec. 464(c)).

Under proposed regulations, for purposes of section 278(b), a grove, orchard, or vineyard in which fruit or nuts are grown in-

cludes any group of trees, bushes, shrubs, or vines which produce a crop or yield of fruit or nuts. A fruit is defined as a fertilized and developed ovary of a plant, including the seeds, or, in the case of a plant that does not bear seeds, the fertile structure of the plant, and a nut is defined as a hard-shelled fruit. For example, fruits or nuts include apples, avocados, coffee beans, grapes, jojoba beans or seeds, pecans, pistachios, and walnuts (Treas. Prop. Regs. sec. 1.278-2(a)(2)).

Some taxpayers have argued that because the jojoba is the seed of a fruit, and inedible, the capitalization requirements for farming syndicates under section 278(b) do not apply to farming syndicates investing in jojoba beans.

Explanation of the Bill

Under the bill, farming syndicates would be required to capitalize the costs of planting, cultivating, maintaining, and developing a grove, orchard, vineyard, or other tract of trees, bushes, shrubs, or vines in which fruit or nuts (whether or not edible) are grown. Thus, the bill would provide that the rules under section 278(b) relating to certain capital expenditures of farming syndicates apply to farming syndicates investing in inedible fruits or nuts such as jojoba beans.

Effective Date

The bill would apply to amounts paid or incurred after March 20, 1984, in taxable years ending after such date.

Revenue Effect

The provisions of the bill are estimated to increase fiscal year budget receipts by $11 million in 1985, $10 million in 1986, $10 million in 1987, $11 million in 1988, and $11 million in 1989.

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